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January 11, 2001

BY COURIER

Vernon A. Williams, Secretary
Surface Transportation Board
Office of the Secretary
Case Control Unit
Attn: STB Ex Parte No. 582 (Sub-No. 1)
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: Ex Parte No. 582 (Sub-No. 1), *Major Rail Consolidation Procedures*

Dear Secretary Williams:

In accordance with the Board's Decision served October 3, 2000, enclosed for filing in the above-captioned proceeding are the original and 25 copies of the Rebuttal Comments of Norfolk Southern in Response to Notice of Proposed Rulemaking. Also enclosed is a computer diskette containing an electronic copy of this document in WordPerfect format.

Also enclosed is an additional copy to be date-stamped and returned to our messenger. Thank you for your assistance in this matter.

Very truly yours,

G. Paul Moates
Donald H. Smith

cc: George A. Aspatore

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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REBUTTAL COMMENTS OF NORFOLK SOUTHERN IN RESPONSE TO NOTICE OF PROPOSED RULEMAKING

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Attorneys for Norfolk Southern Corporation and Norfolk Southern Railway Company

DATED: January 11, 2001

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REBUTTAL COMMENTS OF NORFOLK SOUTHERN IN RESPONSE TO NOTICE OF PROPOSED RULEMAKING

Pursuant to the Board's Notice of Proposed Rulemaking ("NPR"), served October 3, 2000, Norfolk Southern Corporation and Norfolk Southern Railway Company (jointly, "NS" or "Norfolk Southern") respectfully submit these rebuttal comments on the Board's proposed modifications to its regulations governing proposals for major rail consolidations.[1]

INTRODUCTION

Many of the reply comments filed in this proceeding on December 18, 2000, essentially restate the positions set forth in the parties' opening comments submitted on November 17, 2000. Norfolk Southern fully addressed and responded in detail to many of these comments and proposals in its previously-filed Reply Comments. Therefore, NS will not burden the record

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[1] As in NS's prior submissions in this proceeding, abbreviations used in these comments conform to those listed in Appendix A of the NPR (at 69-76). Opening and reply comments filed in response to the NPR are cited by party name abbreviation and "NPR Opening" or "NPR Reply," respectively (*e.g.*, "NS NPR Opening at 4"). As in its prior comments, NS uses the term "merger" as a shorthand reference to all mergers, consolidations, acquisitions of control and other combinations, involving two or more Class I rail carriers, that are subject to Board review under 49 U.S.C. §§ 11321-11326. NS incorporates by reference its ANPR and NPR Opening and Reply Comments.

by repeating its analysis of the parties' previously-stated positions.[2] Rather, the following rebuttal comments emphasize several important and recurring themes raised by the comments of a number of parties, and comment on a few discrete issues raised in other parties' reply comments.

I. THE ROLE OF MERGERS IN FORGING A SOUND AND VIABLE RAIL TRANSPORTATION SYSTEM

The comments of some shippers' advocates reflect an implacable hostility to rail mergers that is not objectively justified by the factual record of the past two decades. The process of consolidation in the rail industry over the past 20 years has been painful at times, both to the shippers involved, and to the railroads themselves. These difficulties were particularly acute during the service crisis following the UP/SP merger and, to a lesser extent, during the service problems that occurred following the NS/CSX/Conrail transaction. But most of these dislocations were temporary and most have now been resolved.

Despite these difficulties, the process of consolidation was necessary in order to achieve a more streamlined and efficient industry -- an industry that is now capable of offering improved and expanded service at competitive rates. The fact that temporary service disruptions occurred during the implementation of prior mergers should not lead the Board to overreact by effectively banning or severely restricting possible future mergers that may offer significant public benefits, including further improvements in service, efficiency and cost savings.

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[2] For this reason , Norfolk Southern's decision to refrain from further comment on particular issues or positions advanced by other parties should not be interpreted as endorsement of or agreement with such positions.

With respect to service improvements, there is no doubt that prior mergers have allowed railroads to offer expanded single-line service, and that shippers have benefited from the ability to ship their products from origin to destination using a single carrier. No commenting party has disputed this fact. In an age when customers have become accustomed to shipping freight by other modes across the country or around the world using a single shipping company, it would be premature to conclude that there are no public benefits to be gained from the creation of rail systems capable of handling freight from coast to coast. Thus, there is no basis to presume *a priori* that possible future rail mergers will have minimal public benefits, or that such benefits are likely to be outweighed by other adverse effects of these potential transactions.

There is also no doubt that prior mergers have allowed railroads to improve efficiency and achieve significant cost savings, through more effective utilization of their physical facilities and equipment, improved productivity, and more efficient management. Rail service has improved and rates have declined. As shown in a recent study by the Board's Office of Economics, Environmental Analysis, and Administration ("OEEAA"), railroad rates declined by 2.7 percent in 1999, continuing a consistent multi-year trend. The study also found that since 1984, U.S. rail rates (adjusted for inflation) have fallen *more than 45 percent.* Most dramatically, the OEEAA study found that rail shippers saved *$31.7 billion* in 1999 alone as a result of rate reductions from 1984 levels (adjusted for inflation).

Some of the same shippers who have benefited from these billions of dollars in rail rate decreases in recent years are contending in this proceeding that past rail mergers have reduced or eliminated competition in the rail industry. This claim cannot be reconciled with reality. *Substantial rate decreases simply do not occur in the absence of competition.* Although

widely repeated, the claim that past mergers have reduced rail competition is based on hyperbole and rhetoric, not evidence.

No commenting party in this proceeding has identified any shipper who has lost competitive rail service as the result of a rail merger. The reason is clear: the Board has taken care to impose pro-competitive conditions where necessary to ensure that no shipper has been deprived of competitive rail service, or suffered other adverse competitive impacts, in recent rail merger proceedings. As confirmed by the Board's recent decision in the UP/SP oversight proceeding, for example, these competitive conditions have effectively remedied any loss of competition that otherwise might have resulted from recent mergers. *See* STB Finance Docket No.32760 (Sub-No. 21), *Union Pac. Corp. – Control and Merger – Southern Pac. Rail Corp. [General Oversight],* Decision No. 16 (served Dec. 15, 2000). The Board has made clear that it will use its oversight power wherever necessary to ensure that such conditions remain effective, and that competition remains vigorous, after a rail merger is approved and consummated.

Because there is no evidence that past mergers have reduced competition in the rail industry, there is no basis for the Board to adopt rules that would impose insuperable barriers to further mergers. In light of the service problems that have accompanied recent mergers, it is entirely appropriate for the Board to apply enhanced scrutiny of the merger applicants' implementation plans, and to examine intensively all of the potential effects of a proposed transaction. If the Board's careful examination of the record in a particular case does not reveal a convincing showing that the proposed transaction would be in the public interest, the transaction should not be approved. But the Board should also take care not to prejudge the merits of future cases, and

deter or prevent potential transactions that may offer substantial public benefits, on the basis of unsupported or inaccurate assumptions regarding rail mergers generally.

II. PROPOSALS TO REQUIRE NON-REMEDIAL ENHANCEMENTS OF RAIL-TO-RAIL COMPETITION AS MERGER CONDITIONS

There is no sound basis in law or policy for the Board's proposal to require non-remedial "enhanced competition" in all future rail merger cases. Such a requirement would bear no relationship to the potential competitive effects of a particular transaction, and therefore would not be merger-related. Such a requirement would exceed the Board's statutory authority, and would be unwise as a matter of policy.[3] In addition, such a requirement is likely to be ineffective because, as Norfolk Southern has already shown, attempts to create artificial competition by regulatory fiat are likely to have adverse effects on service, and may impair, rather than advance, the public interest. NS NPR Opening at 7, 27.

Some shippers strongly support a broad requirement of enhanced competition, because they believe it would drive down rail rates in the short term. None of the commenting parties, however, offers any coherent rationale for the use of proposed mergers as a vehicle for non-remedial relief involving restructuring or reregulating the rail industry generally. NS believes that no such rationale exists. The parties that support this proposal most strongly also propose

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[3] As Norfolk Southern has stated in its prior comments (NS NPR Opening at 14-15), previous rail mergers have in fact resulted in enhanced competition by permitting the merged carriers to compete more effectively with other carriers and other modes of transportation. NS would support a clarification of the Board's proposed rules that would require applicants to show how the proposed transaction would permit effective intramodal and intermodal competition, without requiring applicants to propose additional intramodal competition in every case, regardless of the other competitive effects of the proposed transaction. *Id.* at 16-17.

that it be applied most broadly, including applicants and non-applicant carriers, without regard to the potential effects of the proposed transaction. Many of these commenters simply offer no legal authority whatsoever for the imposition of merger conditions on non-applicant carriers, while other parties concede that the Board has no such authority, and instead urge the Board to open new industry-wide proceedings for the purpose of revising the existing competitive access standards, reversing the *Midtec* decision, and imposing "open access" requirements on the rail industry generally. None of these parties offers any sound basis for reversing the Board's established policies regarding competitive access. These policies are properly based on the Board's existing statutory authority and on sound principles of law, and have been upheld by the courts. No party has offered any persuasive or rational reason for abandoning these policies.

III. THE NEED FOR FLEXIBILITY IN RAIL MERGER REVIEW

In reviewing its merger rules, the Board must balance competing concerns. On one hand, the Board must consider the need for enhanced scrutiny of proposed rail mergers and the need for improved procedures for avoiding service problems and other adverse impacts. On the other hand, in establishing rules of prospective application, the Board must preserve flexibility in dealing with the facts and circumstances of particular cases as they arise and ensure that merger applicants have sufficient flexibility to operate efficiently.

Some commenting parties have expressed a need for certainty, and a desire for merger rules that would guarantee that no shipper ever suffers adverse impacts as a result of a merger. Similarly, some parties advocate rules that would attempt to guarantee that the public benefits of a merger would be achieved on a particular timetable, regardless of intervening events.

But railroads already have powerful economic incentives driving their efforts to achieve a successful merger implementation. After all, railroads will be affected first and foremost by any service difficulties or other problems in merger implementation, and they already have every incentive to achieve the benefits of a proposed transaction. Rigid regulatory rules that attempt to foresee and forestall every conceivable adverse consequence of a complex transaction cannot guarantee success, and are likely to be counterproductive.

In fashioning merger rules, it is essential that the Board avoid attempting to impose preordained solutions for service issues in all future cases. The remedy for any particular service problems must be tailored to the specific facts involved, in order to avoid making a bad situation worse by imposing a "one-size-fits-all" remedy.

Furthermore, it would be inappropriate to adopt a requirement that railroads guarantee that no shipper will ever suffer any adverse impact as a result of a proposed transaction. The Board should not lose sight of the nature of the rail system as an interdependent network. Every action involving rail operations and service causes ripple effects throughout the rail network. Rail managers strive to improve the efficiency of the entire network, but they do not, and cannot, guarantee that every shipper will invariably benefit from every managerial initiative. In other words, a railroads' best efforts to improve service for some shippers is likely to result in adverse effects for other shippers. Similarly, a proposed transaction may produce widespread benefits for the vast majority of shippers and for the public interest, while resulting in temporary service disruptions or other adverse effects for particular shippers. Such a transaction would be in the public interest, and should be approved, even if adverse effects for some shippers are unavoidable.

In practice, railroads make every effort to provide satisfactory service to shippers during merger implementation periods and at all times. Railroads are adversely affected by service failures even more directly than shippers. But as common carriers, railroads are obligated to serve all shippers upon reasonable request, with reasonable dispatch. They cannot guarantee to provide particular service levels to every shipper in the ordinary course of business, and they should not be required to do so in the context of merger implementation.

In addition, the Board should not attempt to mandate that the projected public benefits of a merger must be achieved on schedule and in the manner predicted in the applicants' merger impact analysis. As NS has shown, these impact analyses are based on data from a single year preceding the proposed transaction, and are intended to demonstrate how rail operations in that year would have varied if the proposed transaction had been in effect in that prior year (excluding the effect of other variables). NS NPR Reply at 30-31. But no rail merger is implemented in a "base year." Merger impact analyses are not intended to serve as forward-looking projections of future results, regardless of changing economic conditions and other circumstances beyond the applicants' control. Thus, the rhetoric of certain shippers who advocate that railroads must be required to "keep the promises" made in merger applications (*see, e.g.*, PPL NPR Reply at 18-19) is based on a false premise. A merger application is not intended as a "promise" of projected benefits, but simply represents the best possible analysis of the likely impact of a proposed transaction, based on the best data available at the time an application is filed.

In any event, it would be counterproductive to require railroads to adhere slavishly to every detail of an operating plan in implementing an approved transaction. Given that

operating plans are typically prepared years before merger implementation even begins, such plans may be outdated by the time any merger implementation problems arise. Rail operations are dynamic, and must reflect changing economic conditions and operating requirements. Rail management should be permitted to address implementation problems by responding flexibly to changing conditions, rather than by consulting operating plans prepared years before.

The need for flexibility in merger implementation does not mean that the representations made by merger applicants are irrelevant or meaningless. The merger impact analysis represents merger applicants' good faith efforts to comply with STB regulations which focus on trying to determine, at a macro level, the effects of the proposed merger. But the Board should not use merger impact analyses to prevent railroads from conducting rail operations efficiently in light of changing economic and operating conditions.

IV. THE NEED FOR EXPEDITION OF RAIL MERGER REVIEW

A number of parties have proposed additional procedural requirements that would necessarily extend the time required for merger review proceedings. But as NS and other parties have noted, rail mergers are already subject to longer and more intensive regulatory review than mergers in any other U.S. industry, placing the rail industry at a significant disadvantage in competing for investment capital, discouraging otherwise beneficial transactions, and imposing significant additional costs, including the postponement of decisions regarding commercial initiatives and capital investments.[4] These regulatory delays and costs also impede railroads' ongoing efforts to improve service.

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[4] *See, e.g.*, NS NPR Reply at 51-53; BNSF NPR Opening at 19-21; CN NPR Opening at 10.

In assessing the need for any new procedural requirements, the Board must weigh their possible benefits (if any) against the significant costs that would be certain to result. NS believes that additional procedural requirements will not produce more accurate or just determinations in rail merger proceedings, and therefore cannot be justified. Several parties, including BNSF and CN, have proposed the adoption of a standard procedural schedule calling for completion of major rail consolidation proceedings within one year (subject to modification if necessary in particular cases). BNSF NPR Opening at 8-9, 17-23, 58; CN NPR Opening at 10; *see* NS ANPR Opening at 66; *see also* CSX NPR Opening at 57-60 (suggesting that Board's merger-review process be shortened).

NS believes that such a schedule will provide more than enough time for a careful and complete review of a proposed rail consolidation, and will help to minimize unnecessary costs and delay associated with regulatory review. Therefore, NS continues to support the adoption of a standard one-year procedural schedule in major rail merger proceedings. Of course, adherence to such a schedule should be conditioned on prompt completion of discovery and resolution of discovery disputes, and extensions of the schedule should be warranted if any party engages in dilatory discovery tactics. *See* NS NPR Reply at 52-53.

NS believes that the Board should reject proposals that would lengthen the regulatory review process even further, especially those that serve no purpose other than delay. For example, experience has shown that the environmental review process, while well-intentioned, has already grown too lengthy and cumbersome. The Board can and should fulfill its environmental protection responsibilities without further expanding the scope and timetable of the environmental review process. NS NPR Opening at 53-57; NS NPR Reply at 51-53.

In particular, the Board should decline to adopt proposals that communities should receive more advance notice of proposed rail mergers. Major rail mergers invariably are widely reported in the press well before formal regulatory proceedings commence. Current procedures require that applicants submit a pre-filing notification at least three months in advance before a merger application can be filed. Thus, communities and other interested parties have ample time and opportunity to prepare for and participate in the environmental review process under current procedures. No additional time or notice for particular parties or communities is needed or appropriate.

In addition, the Board should adopt several modifications to its environmental review process. First, NS has proposed a clarification of the rules stating that, in assessing the environmental effects of a proposed rail consolidation, the Board will follow the same balancing approach that it employs in assessing other effects of a proposed transaction. In other words, adverse environmental impacts must be weighed against other merger-related environmental benefits (and other non-environmental public benefits) in the overall approval process, without invariably requiring complete remediation of every discrete environmental impact in its own right. *See* NS NPR Opening, Attachment A at 68 (proposed § 1180.1(f)(1)). NS's proposed rule also clarifies that the Board will confine its environmental impact analysis to direct, merger-related impacts (both beneficial and adverse), rather than normal changes in business and market conditions unrelated to the immediate and direct effects of the proposed consolidation.

Second, although the Board intends to promote negotiated agreements between applicants and state and local agencies and individual communities addressing environmental issues, its proposed rules may actually discourage negotiated agreements by encouraging parties

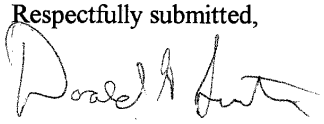
to pursue unreasonable "hold up" negotiating strategies. In order to avoid this unintended result, NS has proposed a modification of the proposed rules to include the statement that "[i]n the absence of such voluntarily negotiated agreements, the Board will determine whether any unresolved issues regarding the effects of a proposed consolidation on the environment or safety should be addressed in the proceeding and, if so, the Board will independently resolve such issues." *See* NS NPR Opening, Attachment A at 69 (proposed § 1180.1(f)(2)). NS believes that this modification of the proposed rule would avoid the creation of incentives for parties to take unreasonable negotiating positions, and would more effectively encourage negotiated agreements regarding environmental impact concerns.

Third, NS urges the Board to reconsider its extensive use of applicant-funded outside consultants in the environmental review process and, at a minimum, to consider measures to reduce the costs of the environmental review process to more reasonable levels. *See* NS NPR Opening at 56-57.

CONCLUSION

For all of the foregoing reasons, the Board should adopt amended major rail consolidation procedures and rules consistent with NS's foregoing comments.

Respectfully submitted,



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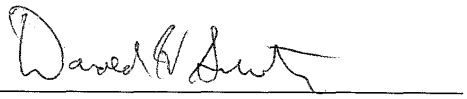
Attorneys for Norfolk Southern Corporation and Norfolk Southern Railway Company

DATED: January 11, 2001

CERTIFICATE OF SERVICE

I hereby certify that, on this 11th day of January, 2001, I served the foregoing "Rebuttal Comments of Norfolk Southern in Response to Notice of Proposed Rulemaking" by causing a copy thereof to be delivered by first-class mail, postage prepaid, to each of the persons listed on the Board's official service list in this proceeding.



Donald H. Smith